RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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Feb. 25, DJIA 1120.94; PTI 1517; A-D Ratio –16.90
Mar. 4, DJIA 1140.96; PTI 1542; A-D Ratio –15.61

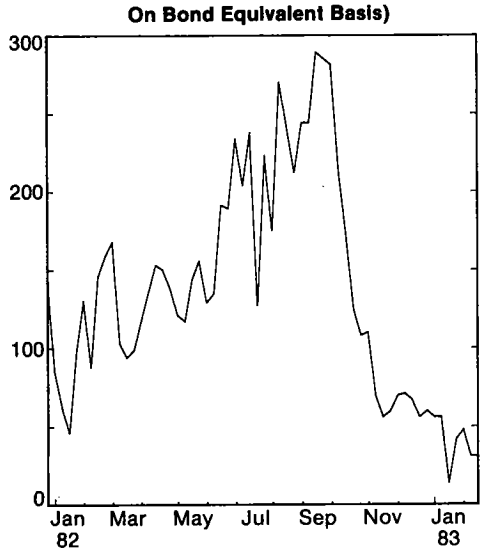
THE MARKETS: In the last Letter I talked about the "shock of recognition." That shock had to do with my opinion that the rise in Russian military capabilities has not yet been comprehended by the average American, and that when the full story finally surfaces we will be faced with a shock of recognition. In case any subscriber is wondering, I have not changed my thinking one iota in this area.

Last week the market responded to another shock of recognition. It was this—there will be NO inflation over the foreseeable future. Neither, it seems, will there be a catastrophe in the area of international finance (nor will there be a collapse in the banking system). How do I know? I don't. But the markets know. And they've already spoken.

Technically, in the space of a single week, gold has turned bearish. The panic break in gold has told us that there is little or no reason to hold inflation hedges here in 1983. Certainly, there is no reason to hold more than a token (core) position in gold coins. As I see it, the gold market is telling us that there may be stability in the period ahead. Or there may be deflation—but the problem will not be inflation. The inflation scenario (judging from last week's gold and stock market action) went "kaput."

As far as a banking crisis, this chart (courtesy of Salomon Bros.) depicts the "fear spread," the spread between the 3-month bank certificates of deposit and the 91-day T-bills. Back in September (when fear was rampant) this spread hit an historic high, and investors were paying a huge premium for the safe T-bills as against the "speculative" bank C/D's. Now that spread is down to almost zero. The market is saying that a bank C/D is almost as "good" as a T-bill. That's the opinion, the verdict of the marketplace. Go argue with it if you wish. But to my mind the market has spoken.

Yield Spread Between Three-Month CDs and Treasury Bills (In Basis Points; On Bond Equivalent Basis)

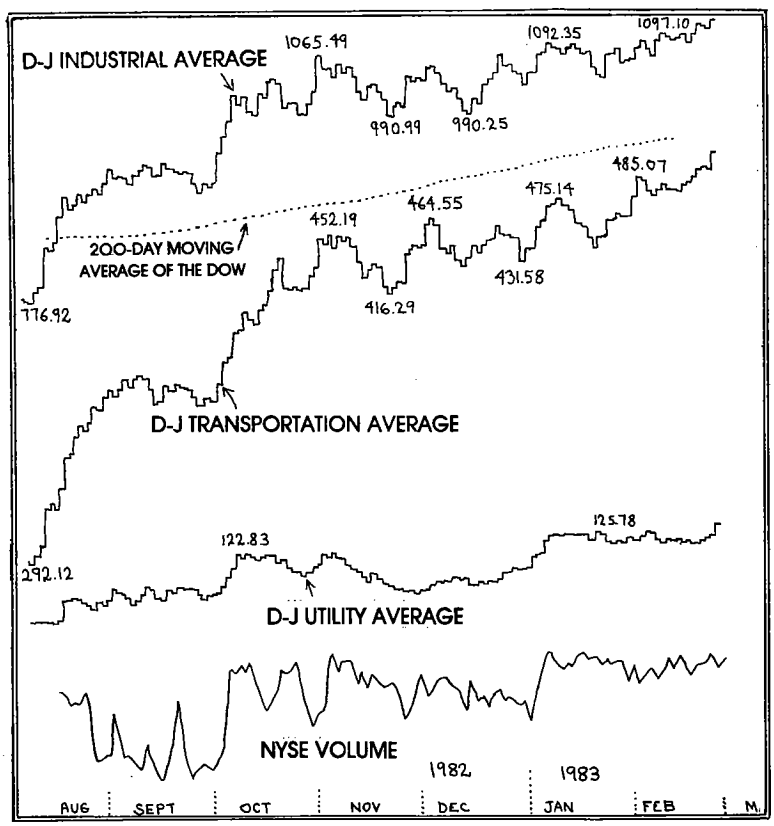


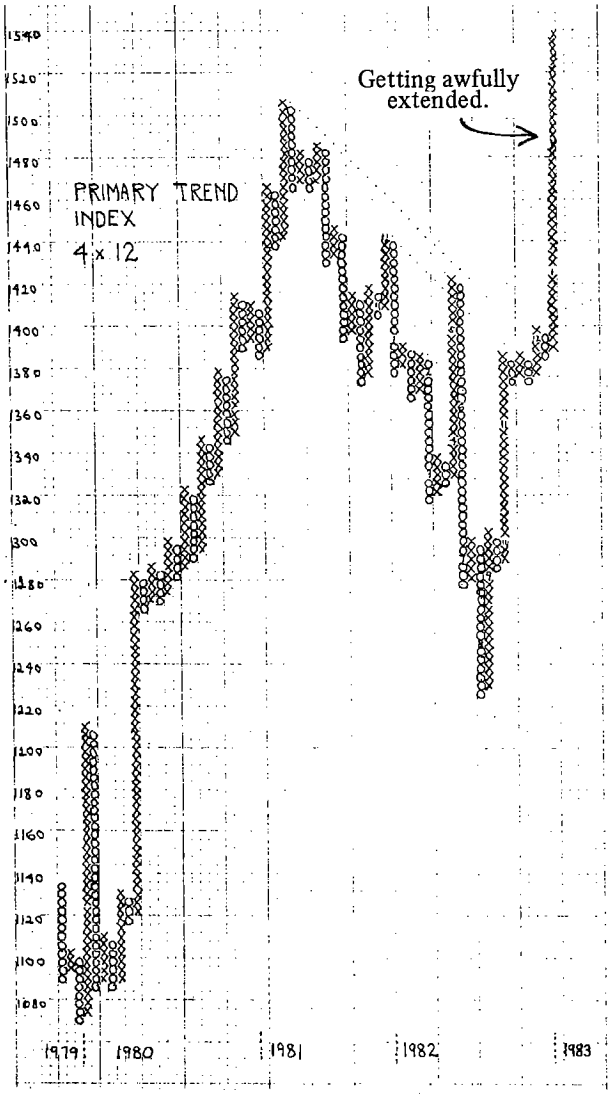
As for the stock market, I believe it is "mulling over" stability vs. deflation. All eyes are now glued on the oil pricing structure, and a thousand opinions have been put forth regarding the ultimate price of oil (I've heard everything down to $10 a barrel). The optimists claim that mildly lower oil prices will spark a world economic boom. The pessimists insist that sharply lower oil prices will throw major banks into a tailspin—thereby setting off a financial crisis.

I don't believe anyone alive knows where oil prices will be six months from now. And I don't think anyone who did know could predict how such a change would affect the markets. But let's examine the most recent action of the markets in view of (1) the weakening oil price, and (2) the crack in the gold price.

The oil-gold weakness is obviously deflationary (dis-inflationary, if you want to be polite). The oil-gold weakness came at a time when the stock market had risen for six months without a major correction. It came when many of the analysts were pointing to "technical weakness" in the market indicators and in the sentiment measures (too many bulls). In a normal market, we might have expected a severe reaction to occur. The street hates uncertainty, and matters were uncertain enough last week.

But the market was not marching to the beat of the headlines. For instance, on March 1 the D-J Industrial and Transport Averages rushed to simultaneous record highs while on the same day Utilities rallied to a 12-year high. The move was confirmed by

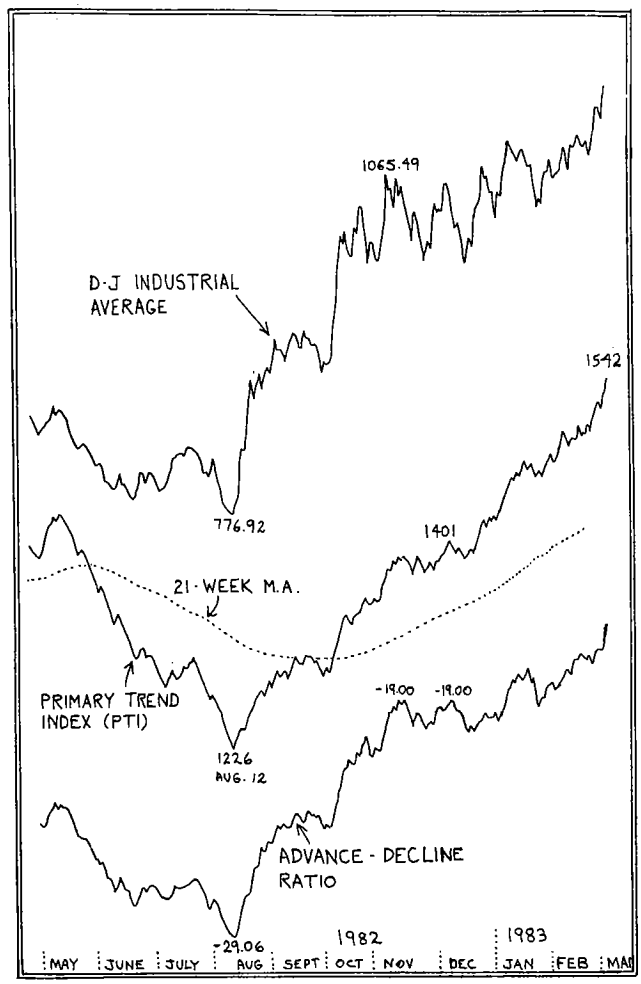




new record highs in the D-J 65 Stock Average, the Value Line Composite, the NYSE Composite and the S&P Composite. The A-D ratio on the NYSE advanced to a new recovery high. And last but not least, the PTI rose to a record high of 1522.

Is there anything wrong with the current stock market picture? The only thing "wrong" can be seen in the point and figure chart of the PTI. Here we see one of the most persistent and explosive advances in the eleven year history of the PTI. The PTI has now advanced for thirteen out of the last fourteen weeks, and this may be putting a strain on the structure. It is a fact that no tree grows to the sky and by the same token no stock market can rally week after week into infinity. The best-conditioned fighter in the world will be tired after 15 rounds, and the stock market is no different. Therefore, it should come as no shock to readers if this market rests a bit in the period ahead. It deserves a rest by any manner of reckoning.

As seen only on the daily chart, the PTI has extended its extraordinary rising trend, and if there is any danger signal buried in the action of the PTI it has not made itself visible yet. By the same token, the A-D ratio has advanced to new recovery highs. and it is therefore fully in gear with the major averages. Prior to trouble, we usually see something out of gear in the major averages and indicators. That has not happened yet.

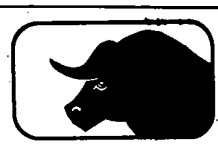


In closing this section I want to write something that many readers will find difficult to swallow. But here goes: I have a great many conservative subscribers. I have a great many subscribers in the so-called "hard money" camp. These people don't like what they see happening in this country. They don't like the wild, liberal spending, they don't like welfare, they don't like mountains of debt and they don't like international give-away programs. And they therefore don't really believe a bull market can occur under these conditions.

But they're wrong. The fact is that the markets know more than all the hard-money conservatives put together. And the markets are saying that (at least for the foreseeable future) the place to be is not gold or collectibles or precious stones. The place to be is in the stock market. My ratio of gold to common stocks has now switched in favor of stocks over gold, and this is the bloodless verdict of the market. The PTI has said, "bull market," the gold market has issued its disinflationary edict. The CRB Commodity Index (27 commodities excluding gold) is at 237, only 11 points from its bear market low and down 8 points from its 1983 high.

From here on it's a case of the markets' verdicts over your own ego. In such a battle, I promise you that the markets will always win (see later section on Egos).

INVESTMENT POSITION: I don't make markets, I follow them. When markets change, I change. The gold and precious metals market has changed and for that reason (see gold section)

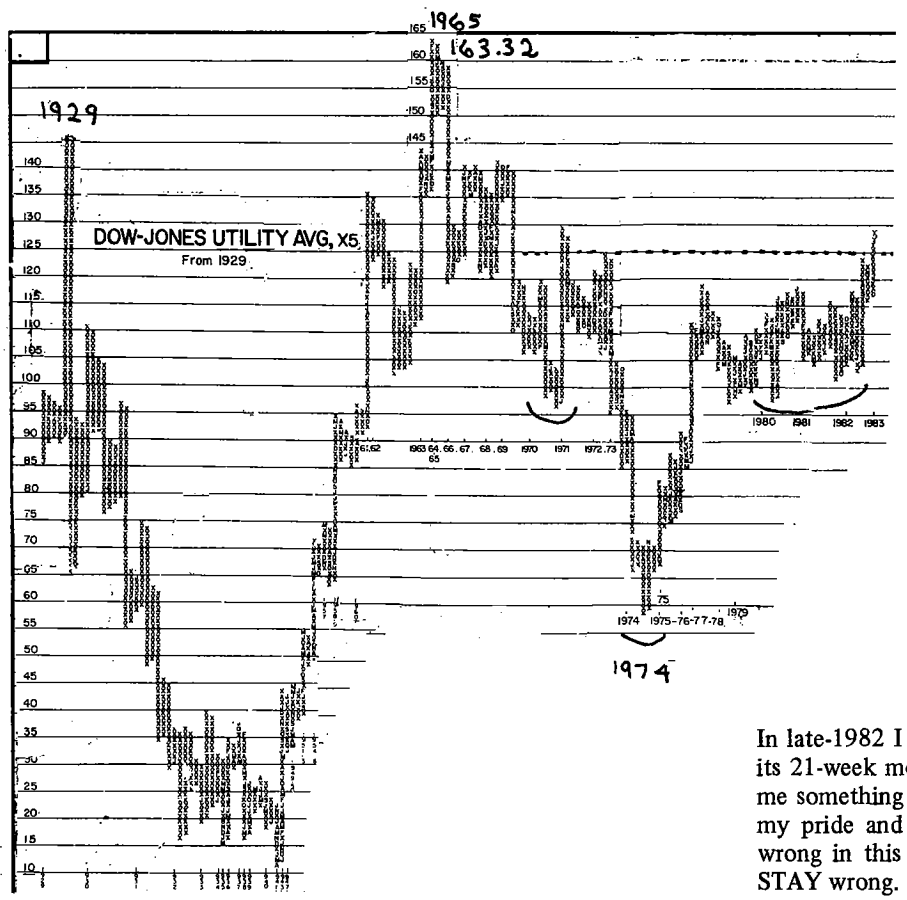


I now recommend a very small or even a zero position in gold and gold shares. I see gold doing little of value on the upside–over the foreseeable future.

I like the Utility stock here (see Utility section), and if you want income these shares are attractive. The following are my choices: Tucson Electric, Consolidated Edison, Minnesota P & L, Montana-Dakota Util., Duke Power, Iowa Southern Util., Southern Calif. Edison.

The defense issues that I recommended in the last Letter should be considered long-term holdings. Do not buy one or two of these, buy the list–even if you have to buy odd lots to do it. The record of these shares will appear in each Letter.

		2/25/83 Price	Current Price	
NYSE	Harris Corp. (HRS)	49½	48 7/8	Defense stock average based on 1 share of each this week is 250
NYSE	LFE (LFE)	11 7/8	11 3/4	
NYSE	Planning Research (PLN)	14 3/8	15½	
NYSE	Scientific Atlanta (SFA)	19	18½	
NYSE	Tracor (TRR)	28 3/4	31 1/8	
AMEX	Bolt Beranek (BBN)	37	37 3/4	
AMEX	BDM (BDM)	43½	49½	
AMEX	Dynalectron (DYN)	123/4	123/4	
AMEX	Moog B (MOGB)	15½	18	
AMEX	Systems Planning (SPZ)	7	6 3/4	
	Original purchase date Feb. 25 '83		239	



UTILITIES: This P & F chart shows the path of the D-J Utility Average from 1929 to date. I think the chart is particularly significant now. I say this because the Utility Average is still below its 1929 high and well below its 1965 "top out" peak of 163.32.

What is so interesting to me is that the Utility Average now has formed an immense head-and-shoulders pattern, a pattern that can only be seen on a long-term chart. Last week, the Utility Average rallied above the 125 level, and I took this to be a break-out above the main resistance line as shown on the chart (horizontal dotted line).

It appears that the Utility Average, after years of basing and consolidation, is now ready to mount a gradual assault on the 1965 high of 163.32. From here on, in other words, the Utility stocks could be surprisingly good performers.

This study has bullish implications for the rest of the market as well. The Utility Average, in the past, has tended to be a bell-wether for Wall Street. In an environment where the Utilities did well, the rest of the market too has tended to prosper. That (hopefully) is the kind of situation we face now in this bull market. (Utility chart courtesy of *Market Charts,* 20 Exchange Place, NYC 10005).

EGO, EGO: This market presents us with one of the greatest examples of "ego destruction" that I've seen in 25 years of Wall Street watching. Despite what you may have thought or heard, the stock market loathes human ego. It has been said, "Nothing created by man himself is so calculated to humble him–as the stock market."

Let me be honest. At the August lows I saw almost nothing in my technical work that indicated a great market bottom. Usually important bottoms are accompanied by major non-confirmations in one Average or the other, or in the A-D or in something. That just didn't happen in August, 1982.

One of the items that keeps me humble is an old adage (which I've had many occasions to think about). The adage states, "The market can do anything." In other words, they don't arrange the patterns and the indicators for Richard Russell or anyone else. The stock market HATES to be taken for granted; it detests "great systems" that are developed to beat it.

Nobody beats the market. Many investors and traders gain from the market, many make correct moves 55% or even 60% of the time. But nobody beats the market. The market has been around for over 100 years and nobody has collected all the marbles yet!

In late-1982 I had to make a decision. My PTI had pushed above its 21-week moving average, and it was obvious that it was telling me something (it wasn't talking, it was shouting!). So I swallowed my pride and made a decision to go with the flow. You can be wrong in this business (and you will be), but woe is you if you STAY wrong.

Yes, there are a number of leading analysts who still insist that this is "a wrong move," a "freak rally," a "phoney rise" or what have you. And they're welcome to that opinion (it's their sleepless nights, not mine). As far as I'm concerned, analysts are often wrong, but the market is never wrong. Around the mid-1950's we used to say, "The charts are never wrong, the problem is with the chartists." And that cynical observation is just as true today.

So it's humility we have to learn if we're to survive on Wall Street. As I said, the market hates human ego. The bigger the ego, the most Wall Street relished grinding that ego to little bits and pieces. I've seen it happen over and over again.

MORE RUSSELL ADVICE: I get dozens of phone calls and letters each week. Most of them have to do with (1) questions about the market, (2) questions regarding subscribers' personal finance problems. Consequently, I have, over the years, learned alot about how people make money and how people lose money.

One of the very basic concepts of investing still seems to escape many subscribers. The concept (I should call it a rule) is this: DON'T LOSE YOUR CAPITAL. Wait, let me put it another way. If you want to be wealthy, leave your capital alone and compound your interest or dividends. If you must, hang on to your capital but spend some of your dividends. Above all, realize that you must have capital to operate in the investment markets. If you spend your dividends and fritter away (or lose) your capital, you are the proverbial carpenter without tools. You may have the brains and the will–but without capital you don't have the wherewithal. You're a financial eunuch.

It may help to view the picture the way I do. I view my capital as a second business. That second business provides me with a second income. I wouldn't think of dismantling a second business that was throwing off income. And by the same token, I won't dismantle (spend away, give away, fritter away) my capital.

Over the years I've seen many tragic examples of people who have gone through fortunes. In every case the financial disasters stemmed from a *basic misunderstanding of the meaning of capital.* If these people had fully understood what I have written above, they never would have put themselves in a position to "go broke."

People ask me, "Russell, how can I operate so that I won't lose my capital." My answer runs something like this: "There's no way that you can be absolutely sure of not losing capital. If the dollar goes to hell, if the nation goes under, if the banking system collapses, the odds are that you are going to lose something. But disasters of those magnitudes are rare, and when they come you simply do the best you can. But in anything like normal circumstances, I would recommend that you keep about half your capital in T-bills or T-notes or money market funds or intermediate-term bond funds–something on that order. The other 50% can be spread around depending on the times. Currently, with the PTI bullish you might have 50% in no-load funds.

Why am I partial to funds? Simple, because they are (1) liquid, (2) under professional management, (3) and finally, because they are diversified and don't go broke. A stock (badly chosen) can become illiquid (difficult to trade) and it can go under. A fund may decline in price, but it won't go broke. Therefore, I find that the average subscriber tends to do better in no-load funds than he does in picking out his own beauties. In other words, he doesn't tend to lose his capital in no-load funds.

I want to enter two exceptions to spending one's capital. The first is in buying a home. A home is like no other investment in that you live in this investment, you (hopefully) enjoy it from the moment of purchase. And finally, there is an emotional satisfaction in owning your own home that is unique.

The second exception to spending your capital is when you develop an expertise in a certain area–and you decide to start your own business. To my mind, one's own business is potentially the best investment and most satisfying achievement for an individual. Therefore, I make those two exceptions regarding spending one's capital. Both areas (your own house and your own business) bring enough satisfaction so that they warrant the using of one's basic tool–his capital.

DEBT, DEFICITS: I just read a most interesting article by Steve Leuthold in which the author compared today's conditions with those of the 1920's. The comparisons are great until Steve comes to the following: "Confidence building was important to the post-1921 economic and stock market recovery period. The US continued to reduce the national debt in this period from a WW 1 peak of $27 billion to about half of that only a decade later. Here, then, is where this pleasant little comparison breaks down."

That's right. If there were comparatively little debt today interest rates would be collapsing, gold would be selling for under $100 and the Dow would be nearer 3000 than 1000. Yes, it's the debt that is making the difference. To "handle" the debt and the adverse deflationary pressure of the debt, the Fed is doing the only thing it knows how to do under the circumstances–and that is, inflate the money supply. If there were little debt, if corporations and states and the US Government were really solvent, then we would be entering a mighty boom period.

But why dwell on what might have been? The debt is there, trillions of dollars of debt, and it is still growing. In the face of this and with the help of a low level of inflation the market is, nevertheless, moving into new high territory. And when you think about it, in view of the unbelievable levels of debt, the bull market of 1982-83 is a sort of financial miracle.

How are the debts going to be handled? Does the market know something that we don't know? Perhaps, and my feeling is that the market is saying that a debt crisis will be held off for perhaps a year, perhaps a few years. And during that period the bull market can flourish. Or could it be that the market is saying that some new plan, some newly created international agency, will "sanitize" the debt? Again, maybe. But I never argue with a bull market. Ours is not to reason why. Ours is either to get aboard the market or stand aside–but certainly we don't fight the bull. Once I became convinced that the bull was in command I placed the bovine in the "Investment Position" box–and he's been in there ever since. At present there are near 100 million shorts outstanding. They simply don't believe what they see. I can only say to them, "Good luck, fellows. You'll need it–to rebuild what's left of your capital." Because it is a primary bull market.

NOTES & QUOTES: One of this year's hottest "think books" is *Megatrends* by John Naisbitt. USA Today interviewed Naisbitt, and I thought the opening Q & A was interesting. (see page 5).

USA TODAY: Where do you see this nation heading?

NAISBITT: We are letting go of our old industrial base and we are well on our way into the new economy resting on knowledge and electronics. To be very simple-minded about it, we are moving from an economy resting on the motor car to an economy resting on the computer.

USA TODAY: Your book, *Megatrends*, seems to say the nation should forget about rebuilding its steel and auto industries, abandon its role as an industrial leader and allow the Third World to displace us?

NAISBITT: It's not about letting the Third World have it. They are taking it. We have to recognize we lost it in 1950, at the height of the industrial period. Following World War II, the United States produced 50 percent of the world's steel. Last year, we produced 13 percent of the world's steel, and that's the trend. The United States and all other developed countries are letting go of these old industrial tasks while they are increasingly being taken up by the Third World. Automobiles and steel are not coming back. Textiles, shoes, apparel, and all of those things in machinery that we did during the industrial period, they're all receding.

USA TODAY: Are we beating Japan in the new information-based areas?

NAISBITT: We have lost, for example, in telecommunications, to use a generic term. We've lost in the last 10 years our world share of the market from 60 percent to 20 percent. We can continue to lose in these areas unless we really put our energies, our capital and all our innovative creativity against this. Japan is not beating us now but she is coming up very strong in these areas, as are some other countries.

10 trends

These are the 10 primary trends that John Naisbitt forecasts for America in the 1980s and beyond:

- Industrial society becomes an information society.
- Human interaction increases with technology's growth.
- National economy integrates with world economy.
- Planning emphasis shifts from short term to long term.
- Society becomes increasingly decentralized
- Self-help moves to replace institutional help.
- Representative democracy grows more participatory.
- Rigid managerial structures dissolve.
- Business, industry and population move south.
- Consumer goods grow increasingly diversified.

Source: *Megatrends*

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Help! A San Diego May Co. executive was quoted, "Lord, they've done it again!" What have "they" done? It's the Japanese. Brothers Co. is out with a hot selling electronic typewriter–it's portable. It sells for $199. But the shocker–the new typewriter weighs 5 pounds. Reports are that it's an instant sellout.

* *

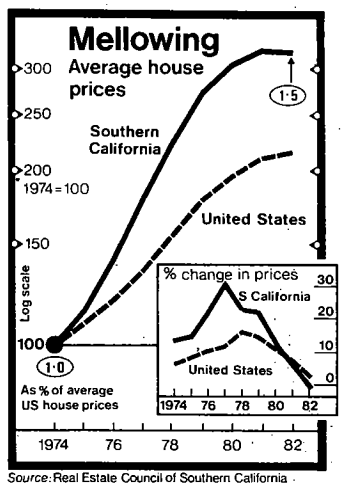
Pigs or Chicks: This year, for the first time in history, US consumption of chicken may pass pork. Since 1980 per capita consumption of pork has been declining, since 1976 per capita consumption of beef has been declining. Price of chicken was $.60 a pound in 1973, it is now (retail) $.72, a rise of only 20%. Pork was $1.09 in 1973 and is now $1.86, a rise of 70%. Beef was $1.42 in 1973 and is now $2.50 a rise of 76%. The bargain obviously is chicken.

* *

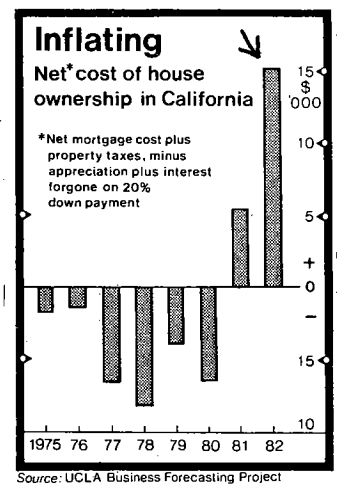
The "I Take It Back" Dept.: Twenty years ago I went on an electric razor spree. But they didn't work very well, and I shortly gave up on them. So for the next twenty years I used soap, lather and all manner of blades. Then a month ago I bought first a Panasonic electric and second a Remington. They work! I love them. I can shave twice, three times a day with the electrics. Science marches on, and my face feels better. Goodbye to lather, shaving brushes, razors, wasted time (I can shave while I read the WSJ and never even nick myself).

* *

For those still skeptical of the deflation scenario, gaze at this chart of the once white-hot California real estate market. Note that by 1981 the price of a California house was 1.5 times that of a house in the rest of the country. But the rate of change started to level off in 1977. And the rate of change is down to about 2-3% per year today. Lesson: if you need a house to live in–go to it. If you're buying a house as an inflation hedge forget it. Gold, commodities, and now houses are all saying the same thing–No inflation over the foreseeable future. The second chart shows why people are having second thoughts about buying a home (both charts from the Economist).



Source: Real Estate Council of Southern California



Source: UCLA Business Forecasting Project

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The response from the Defense article in the last Letter was startling. I received encouraging calls and letters from all parts of the nation. Unhappily, I have not been able to answer most of the letters, but I do thank those of you who wrote or called. Incidentally, *Time* magazine (last week) featured a cover story on the waste in the military. The story was both fascinating and depressing. Nobody knows how many tens of billions of dollars have been wasted, grafted, inflated or just plain stolen out of the defense program. The only consolation is that the Russians are probably just as inefficient and corrupt as we are.

This week's London *Economist* had a fine piece comparing Russia and Nazi Germany. Their conclusion, I felt, was valid. Nazi Germany glorified in war. Russia does *not* want war. But Russia will use her military forces anywhere she can, as long as it is "safe" (such as in Afghanistan). Russia will use her military build-up as a bullying device,and she will push, push, push. And the bullying is working. Note West Germany currently wavering, not knowing whether to move towards the US or towards Russia. The first Russian objective may be an attempt to control Mid-East oil.

States the Economist: "Russia would prefer an intimidated, bottled-up Western Europe. . . . . They would also like a Western Europe which sold its exports to Russia cheaper, and bought

imports from Russia dearer, than it is presently inclined to do. . . One way of making Western Europe docile would be to bring the source of the oil on which Western Europe depends within the Soviet sphere of influence. . . . Mr. Andropov is not Hitler, but the problem he poses for free Europeans is as big and as bad."

GOLD: I stated in the last two Letters that gold's problem was that it had to hold decisively above the 500 level–hold above 500 for a few weeks or longer. That never happened. The bearish progression from that failure was rapid and dramatic.

On February 23 gold opened (first London fix) at 479, well below the 5-week moving average. On February 24 the first London fix was 473.75, below both the 13-week moving average and the rising trendline (see the last Letter for the trendline chart). On February 28 the early London fix was 419.75, and this took gold below even the 50-week or primary moving average. Gold later dropped to the 400 mark.

What can we deduce from this wide-open panic, a panic which cut 25% from the gold price in a matter of a day? Here's the way I see it. First, there's to be no inflation over the foreseeable future. Second, all my bullish guages and levels have been shattered by the yellow metal. Gold has turned bearish, suddenly, shockingly and decisively.

Many will blame the gold collapse on the weakening oil-price structure. But lower oil prices have dominated the headlines for months. Others will blame the gold dive on "too much bullishness regarding the metals." Widespread bullishness could pave the way for a correction, but hardly a panic of these proportions.

My own feeling is that something in the fundamentals has changed. That change entails the gold market's view of inflation. Gold (I believe) is telling us that we are entering the period of "the great unwinding." With the price of oil declining, with the consumer price index almost static, with the onus of debt hanging over everyone's head, the gold barometer is saying that no inflation hedge is needed. It is saying that for the foreseeable future cash and stocks are to be king. And that is the reason that tens of millions of ounces of gold were swapped for cash during the past few weeks.

Technically, one factor is of particular interest to me. Gold crashed from its 1980 high of 850 to its 1981 low of 298, a loss of 552 points. The halfway level back to the high (from the bear market low to the 1980 bull market peak) was 574. Normally, following a panic bear market decline one can expect the price to work itself back to the halfway level of the entire decline.

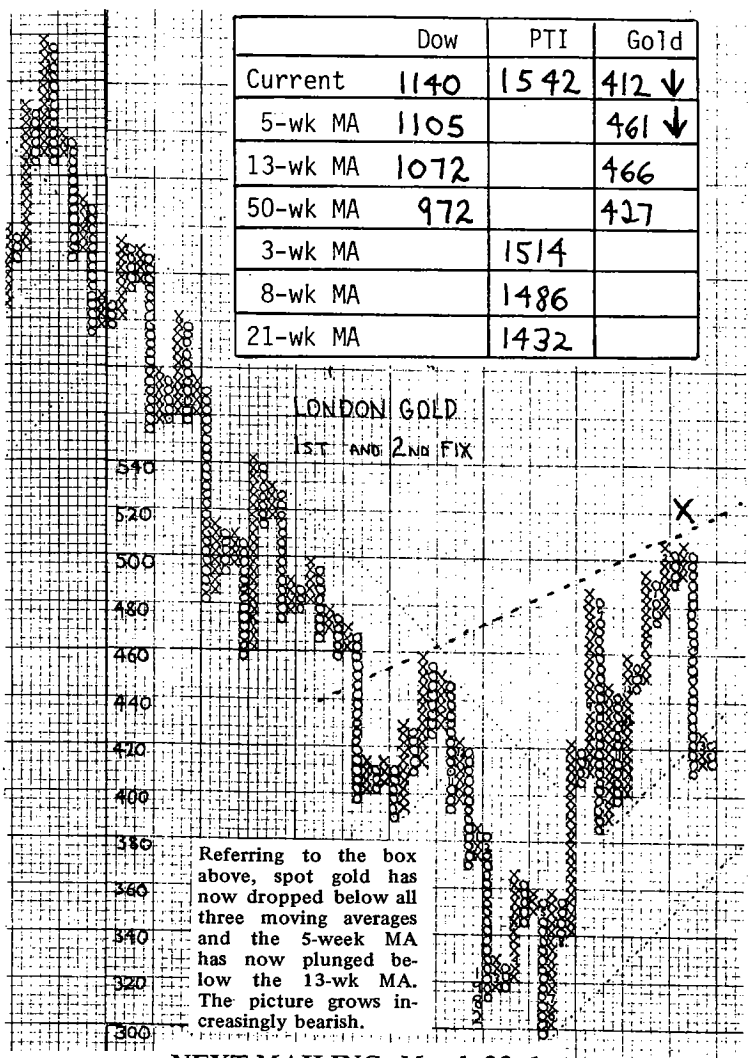
On that basis, we might have expected gold to at least test the 574 level. But gold, after forming a huge head-and-shoulders base, failed to rise decisively out of that base. A decisive push would have meant a rally well above 500. So gold failed to fulfill its technical potential in that it failed to rise out of its H & S base, and it failed (obviously) to recoup even half its 1980-81 losses. Having failed on both counts, it collapsed. My guess is that a whole new basing period will be required, and this will take time–a lot of time.

For the benefit of subscribers, I guess I should put it in starker terms. I feel that the back of the 1981-82 gold rise has now been broken. I don't know whether gold is going to flop around in an effort to re-base, or whether a new bear market has started in gold. I will want to see how my moving averages position themselves, and that's going to take time.

But my instinct here is to say, "Unload most of your gold and gold shares. The picture has changed. Gold will not be needed over the foreseeable future, there's just no sense trying to beat a dead horse."

The point & figure chart of gold is worth studying. When the market doesn't do what it's supposed to do it is usually telling us something. Gold had formed a large head-and-shoulders bottom, as seen on the chart. I pointed this out in previous letters, but I also noted that "everybody" was aware of this fomation, and what everybody knows often isn't worth much. Normally, gold should have broken out to the upside at point X on the chart. Instead, gold broke down violently–on little or nothing in the way of news (in other words, the break was purely technical).

When a breakdown of this kind of force (momentum) occurs, I never take it lightly. My guess is that gold (at best) will now lapse into a trading range bordered by 450-475 on the upside and 385 on the downside. A series of London spot fixes below 400 would suggest the possibility of an ultimate test of the bear market low in the 300 area. (Short term: a London fix at 405 or lower could send gold down to test the 380 level).



NEXT MAILING: March 23rd